



BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking on the Commission's own motion for the purpose of considering policies and guidelines regarding the allocation of gains from sales of energy, telecommunications, and water utility assets.

R.04-09-003

REPLY COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES

I. INTRODUCTION

Pursuant to the Administrative Law Judge (ALJ) Ruling of June 29, 2006, in this proceeding, the Division of Ratepayer Advocates (DRA) files these Reply Comments in response to the Opening Comments of the California Water Association, California-American Water Co., and the Park Water Co., as they pertain to the two Section 790 issues specified in the ALJ Ruling.¹

Initially, the ALJ Ruling specified three issues for the parties' comments, which the parties filed on July 20, 2006. Subsequently by stipulations of all the parties, the assigned ALJ Sarah Thomas granted an extension of time until September 8, 2006, for the parties to meet and confer or file reply comments regarding the definition of the term "major facility" in Section 455.5 both for all public utilities. However, the parties' reply comments pertaining to the two Section 790 issues are due by August 21, 2006.

¹As stated in DRA's Op. Comm'ts filed July 20, 2006, pursuant to Rule 2.2(d) the Utility Reform Network (TURN) has authorized DRA to sign joint comments on its behalf. However, because these DRA Reply Comm'ts exclusively pertain to water utilities, TURN is not joining DRA in these comments.

II. DRA ARGUMENTS AND AUTHORITIES

A. Because CIACs are not at any time included in rate base, Section 790 does not apply to the gain on sale of CIACs.

The Commentators – California Water Association, California-American Water Co., and the Park Water Co. – *inter alia* argue that under Section 790 the rate of return authorized for real property in rate base must also apply to utility infrastructure purchased with gains from the Section 790 sale of CIACs.² As CWA proclaims,

There is no ambiguity here. The statute contemplates one class of ‘Section 790 property’ (“All water utility infrastructure . . .”), one rate base (“ . . . the water corporation's other utility property...”), and one rate of return (“ . . . a reasonable return”). The statute is clear.³

However, the Commentators fail to note that Section 790 only applies to real property that “was at any time” included in rate base. Because the Commission excludes CIACs from rate base at all times, Section 790 does not apply to CIACs at any time. Therefore, Section 790 does not apply to the gain on sale of CIACs.

Subsection (a) of Section 790 in pertinent part allows water utilities to sell unneeded real property “that was at any time, but is no longer, necessary or useful in the performance of the water corporation's duties to the public.” In the *California Water Service Co.* decision, the Commission found that

Real property that is “necessary or useful in the performance of a water corporation's duties to the public” would have been included in a water utility's rate base upon which it earned a return . . . The Infrastructure Act requires water utilities to sell unneeded property that “was at any time” included in rate base, and to reinvest the net proceeds in water utility infrastructure.⁴

² See Op. Comm’ts of Calif. Water Ass’n, California-American Water Co., and Park Water Co., re ALJ Ruling of June 29, 2006, each dated July 20, 2006, on file with DRA.

³ CWA Op. Comm’ts 10.

⁴ *Cal. Water Serv. Co.*, D. 03-09-021, 2001 Cal. PUC LEXIS 1249, at *101 & *104 (dated Sept. 4, 2003).

However, it is established Commission policy that CIACs are not included in the determination of rate base, when they are received.⁵ When CIACs are sold, the Commission also excludes them from rate base, as follows:

[T]he "fair market value" is based on the value of land and "company funded plant assets" (footnote omitted) -- non-utility funded plant such as Contributions (footnote omitted) and advances are not included in the valuation. This decision [D.98-11-019] also defines the value of "non-rate-based assets" (footnote omitted) such as those funded with Contributions and Safe Drinking Water Bond Act (SDWBA) loans at their existing book value on the books of the selling utility. Since these items are not included in the valuation of a water utility's "fair market value," the selling utility receives no compensation at the disposal of contributed plant. The purchasing utility does not earn a return on either the existing book value or any premium to account for market value at the time of acquisition, since the contributed plant is recorded at its existing cost (not inflated for market value at the time of sale) in Contributions, which is deducted in the calculation of rate base. [Emphasis added.]⁶

The Commentators have presented no legal authority rebutting the decisions quoted above that show CIACs are never allowed in rate base. Therefore, Section 790 is inapplicable to CIACs.

Second, notwithstanding subsection (a) above, Section 790 raises considerable risks of water utilities inappropriately "churning" CIACs to increase rate base. As the Commission noted in D. 06-05-041,

CWA agrees that it is a 'valid concern' that "water utilities will improperly characterize real property with little or no rate

⁵See *OIR re Gov't Financed Funding*, Findings of Fact 7, D. 06-03-015, 2006 Cal. PUC LEXIS 217, at *36 (As with CIACs, gov't funded contributions are ineligible for rate base recovery, records, and depreciation.).

⁶*Id.* at *26 and *27 note18 (regarding the sale of the Lucerne Water Co. to the Dominguez Water Corp.), citing *Dominguez Water Corp.*, Findings of Fact 12, D. 98-11-019, 82 CPUC2d 670, 1998 Cal. PUC LEXIS 770, at *16 (dated Nov. 5, 1998) (The term "non-rate-based assets" means "SDWBA Funded Plant" and "Contributions in Aid of Construction.").

base value as no longer necessary or useful for public utility service just in order to sell such property and reinvest the net proceeds in new plant that will qualify for rate base treatment.”⁷

Analogously, water utilities could improperly characterize CIACs as no longer necessary or useful for public utility service just to sell the CIAC property under Section 790; reinvest the gain on sale of the CIACs in other utility infrastructure; and thereby qualify CIACs for rate base recovery and profits, which otherwise would be prohibited. This potential abuse further militates against applying Section 790 to the gain on sale of CIACs.

Third, CWA claims that Section 790 overrides the Commission’s established ratemaking treatment of CIACs.⁸ This conflicts with the following Commission holding:

The directives of § 790 must also be considered in the context of extant Commission authority over water utilities. The Commission maintains complete authority over water utility rates, see, e.g., § 454, and the sale or encumbrance of utility property, § 851. The Legislature has granted the Commission far-reaching authority to "supervise and regulate" utilities in this state as set out in § 701. In adopting § 790(e), the Legislature explicitly recognized the Commission's ongoing authority "to determine the used, useful, or necessary status of any and all infrastructure improvements and investments." This authority takes on enhanced importance in the case of rate base assets that the water utility proposes to transfer pursuant to § 790 due to the financial incentives Cal Water believes § 790 creates. Thus, we conclude that the Legislature expected the Commission to continue to exercise its authority over water utilities and to scrutinize sales and purchases proposed by water utilities pursuant to § 790.⁹

Therefore, as subsection (e) of Section 790 shows, the statute’s legislative intent is to uphold the Commission’s ratemaking authority. CWA offers no legal authorities that

⁷ *OIR Gain on Sale*, D. 06-05-041, 70 (mimeo) (dated May 30, 2006).

⁸ See *CWA Op. Comm’ts* 10 – 12.

⁹ *Cal Water Serv.*, 2001 Cal. PUC LEXIS 1249, at *100 – *101.

invalidate the Commission's plenary authority to exclude CIACs from rate base before and after their sale. Therefore, the Commission's ratemaking treatment of CIACs renders Section 790 inapplicable to the gain on sale of CIACs.

B. The Commentators have not rebutted Commission decisions that hold Section 790 does not apply to direct or inverse condemnations

In its July 20, 2006 Opening Comments, DRA cited two Commission decisions that held Section 790 is inapplicable to direct or inverse condemnations, re *San Gabriel Valley Water Co.*, D. 04-07-034 and D. 06-06-036.¹⁰ The Commentators rely inter alia on two cases to argue that condemnation proceeds for real property, both direct and inverse, should be treated as sales subject to Section 790: *San Gabriel Valley Water Co. v. Montebello* and *San Gabriel Valley Water Company*.¹¹

However, Section 790 was not at issue in either the *Montebello* or *San Gabriel* cases cited by the Commentators. In the *Montebello* case, the City of Montebello et al. sought review of a judgment entered by the Superior Court of Los Angeles County which awarded San Gabriel Valley Water Co. \$ 350,000 for damages suffered as a result of a taking by Montebello under Cal. Pub. Util. Code §§ 1503.12 Section 790 was not discussed and formed no part of the court's holding. Similarly, in *San Gabriel* Section 790 was not an issue and does not comprise any part of the court's decision.¹³ Therefore, the two Commission decisions, D. 04-07-034 and D. 06-06-036, as cited by DRA above,

¹⁰DRA Op. Comm'ts 5–6.

¹¹ CWA Op. Comm'ts 19 – 20, citing *Montebello*, 84 C.A. 3d 757, 148 Cal. Rptr. 830, 1978 Cal. App. LEXIS 1916 (1978) and *San Gabriel*, D.92273, 4 CPUC2d 339, 1980 Cal. PUC LEXIS 1211 (1980).

¹² See *id.*, *Montebello*, 1978 Cal. App. LEXIS 1916, at ***14 – ***15 (issue was proper amount of just compensation in an inverse condemnation proceeding).

¹³ *Id.*, *San Gabriel*, 1980 Cal. PUC LEXIS 1211 (D. 92273 amending D. 92112 to correct for accounting procedures used in calculation of rate base and refunds).

stand unrefuted. The Commission should conclude as a matter of law that Section 790 is inapplicable to direct or inverse condemnation proceeds.

III. CONCLUSION

For the reasons stated above, DRA respectfully urges the Commission to hold that Section 790 does not apply to the gain on sale of CIACs that is reinvested in utility infrastructure. Further, direct or inverse condemnations do not constitute a sale for Section 790 purposes.

Respectfully submitted,

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August 21, 2006

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a copy of ‘**REPLY COMMENTS OF THE DIVISION OF RATEPAYER ADVOCATES**’ in R.04-09-003 by using the following service:

☒ **E-Mail Service:** sending the entire document as an attachment to all known parties of record who provided electronic mail addresses.

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Executed on August 21, 2006 at San Francisco, California.

/s/ ANGELITA MARINDA
Angelita Marinda

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address and/or e-mail address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

CALIFORNIA PUBLIC UTILITIES COMMISSION
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